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December 28, 2004

VIA FACSIMILE AND FIRST CLASS MAIL

Defense Acquisition Counsel
Attn: Ms. Amy Williams
OUSD(AT&L)DPAP(DAR)
IMD 3C132
3062 Defense Pentagon
Washington, D.C. 20301-3062

**Re: DFARS Case 2003-D106
Defense Federal Acquisition Regulation Supplement;
Transition of Weapons-Related Prototype Projects to
Follow-On Contracts
69 Fed. Reg. 63329 (November 1, 2004)**

Dear Ms. Williams:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter.¹ The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

¹ Mary Ellen Coster Williams, Council member of the Public Contract Law Section, did not participate in the Section's consideration of these comments, and she abstained from voting to approve this letter.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.²

Introduction

The interim rule implements section 847 of the National Defense Authorization Act for Fiscal Year 2004. That section allows the U.S. Department of Defense ("DOD") to treat as a commercial item procurement a contract for an item or process with a nontraditional defense contractor that follows up that contractor's successful performance of an "other transaction" with the Defense Advanced Research Projects Agency ("DARPA") to carry out basic, applied, or advanced research. It also allows DOD to treat funding, for purposes of determining rights in technical data and computer software, as mixed.

The interim regulation largely restates section 847 and does so accurately. In doing so, the *Federal Register* notice states that publishing an interim rule prior to public comment was necessitated by "urgent and compelling reasons." Section 847, however, became effective a year ago and it is not clear why the matter could not have been addressed as a proposed rule at an earlier point in time. The Section nevertheless agrees that implementation is needed and the interim rule accomplishes this.

Clarify Application of Section 847

Section 847 itself seems to raise some issues that we would like to highlight for your consideration as may be appropriate. The meaning of "nontraditional defense contractor" is central to this interim rule. DFARS 212.7001 provides the following definition of that term, which is the same as provided in 10 U.S.C. § 2173, note,

- Nontraditional defense contractor means a business unit that—
- (1) Has entered into an other transaction agreement with DOD; and
 - (2) Has not, for a period of at least 1 year prior to

² This letter is available in pdf format at <http://www.abanet.org/contract/federal/regsgcomm/home.html> under the topic "Research & Development/Intellectual Property."

the date of the other transaction agreement, entered into or performed on—

(i) Any contract that is subject to full coverage under the cost accounting standards described in FAR Part 30; or

(ii) Any other contract exceeding \$500,000 to carry out prototype projects or to perform basic, applied, or advanced research projects for a Federal agency that is subject to the FAR.

A DFARS rule should clarify a statute's application when it is ambiguous. Section (2) of this definition contains the phrase "performed on," which is subject to conflicting interpretations. If a business unit provided its commercial product to the contractor performing a contract subject to full CAS coverage, does that mean it "performed on" that contract? What if the commercial item were only a small part of a large contract? Or even if a large part, what if the commercial item could have been easily replaced by other commercial items? What if the commercial item were an administrative service? Do overhead items count as being performed on such a contract? The Section believes, as discussed below, that Congress's intent was to distinguish business entities that have developed systems to meet unique government contract requirements from those that have not. Thus we suggest the "performed on" phrase be defined as, for example, "having participating directly and substantially enough in a government contract to require compliance with CAS or the FAR cost principles, or both, or submission of certified cost or pricing data."

Another ambiguity exists in (2)(ii) because (2)(ii) appears to be addressing two circumstances in a single paragraph. There are at least four different ways to interpret (2)(ii), and the interim rule does not clarify this either. These interpretations are:

1. "any other contract exceeding \$500,000 to carry out prototype projects that is subject to the FAR," AND "any other contract exceeding \$500,000 to perform basic, applied, or advanced research projects for a Federal agency that is subject to the FAR."
2. "any other contract exceeding \$500,000 to carry out prototype projects," AND "any other contract exceeding \$500,000 to perform basic, applied, or advanced research projects for a Federal agency" that is "subject to the FAR." In this case, "subject to the FAR" modifies "Federal agency," i.e. this whole thing doesn't apply to FAA, TSA, the Postal Service or other agencies that are not subject to the FAR.

3. "any other contract exceeding \$500,000 to carry out prototype projects," for a Federal agency that is subject to the FAR AND "any other contract exceeding \$500,000 to perform basic, applied, or advanced research projects for a Federal agency that is subject to the FAR."

It may be that (2) should have been written as follows:

(2) Has not, for a period of at least 1 year prior to the date of the other transaction agreement, entered into or performed on –

(i) Any contract that is subject to full coverage under the cost accounting standards described in FAR Part 30; or

(ii) Any other contract exceeding \$500,000 to carry out prototype projects for a Federal agency that is subject to the FAR; or

(iii) Any other contract exceeding \$500,000 to perform basic, applied, or advanced research projects for a Federal agency that is subject to the FAR.

The final rule should clarify this ambiguity.

The statute should be liberally construed to support its purposes, which furthers the governmentwide drive in recent years to attract nontraditional defense contractors to the government market and particularly to research and development projects. It is the Section's understanding that some commercial firms have contracts for projects that exceed \$500,000 with agencies that are "subject to the FAR." These companies, however, may not be subject to CAS, the cost principles, or other government-contract-unique requirements. These companies should be able to qualify as nontraditional defense contractors but cannot as the regulation is now written. They operate as commercial contractors and bring the same potential for new thinking as those commercial firms that do not have such contracts. DOD may wish to consider how to refine the language of the interim rule to ensure that DOD is not denied the benefits that these essentially commercial businesses continue to bring to the government. If the Department agrees with our concern, but does not believe the DFARS can so interpret the statute, then it may wish to consider further legislative proposals.

We note that we have commented on aspects of related definitional problems previously. In comments regarding DOD's OT guidance submitted on

June 8, 2001 (available at

http://www.abanet.org/contract/federal/regsgcomm/rd_006.pdf), we stated:

The Section recommends that the *OT Guide* use the term “business entity” found in the statute instead of “business unit” or “segment” to achieve more flexibility. If the *OT Guide* defines a business entity as an established operation that was not otherwise subject to government cost accounting through either holding a cost reimbursement contract or application of CAS to its cost center, the flexibility needed to identify and attract commercial operations to DOD work might better be achieved.

Section comments on audit rights also touched on this theme. See Comment Letters dated August 4, 2000 (available at http://www.abanet.org/contract/federal/regsgcomm/rd_004.html) and January 22, 2002, (available at http://www.abanet.org/contract/federal/regsgcomm/rd_007.pdf). The Section believes that a failure to address these issues will adversely affect the Department’s ability to fully mobilize the commercial sector’s research and development capability.

Guidance on Using Fixed-Price Contracts

The statute requires that the authority only be used with firm fixed-price or fixed-price contracts or subcontracts. Section 847(c)(2)(e)(3)(B). Using such contracts can be very difficult for the first production contract because neither the contractor nor DOD may have sufficient knowledge to adequately estimate the cost to produce. Given this difficulty, the FAR should provide that if such contracts are used, particular, careful attention must be focused on (i) adequately defining performance, including addressing difficult to quantify risks expressly, (ii) using interim fixed-price milestones and also consider allowing later milestones to be priced during performance as more knowledge is gained, and (iii) ensuring that payments, including incentives, are linked to achieving clearly defined cost and technical performance objectives. Compare FAR 16.202-2. Although the Section is aware of the current ongoing effort to streamline the DFARS, it seems crucial here to include at least this high level guidance to assist all parties.

Qualifying Subcontracts

The treatment of subcontracts with nontraditional defense contractors appears unnecessarily restrictive. Section 847 combines its treatment of subcontracts with its discussion of prime contracts in the following provision:

(A) a qualifying contract for the procurement of such an item or process, or a qualifying subcontract under a contract for the procurement of such an item or process, may be treated as a contract or subcontract, respectively, for the procurement of commercial items, as defined in section 4(12) of the Office of Federal Procurement Policy Act (41 U.S.C. 403(12)); and

(B) the item or process may be treated as an item or process, respectively, that is developed in part with Federal funds and in part at private expense for the purposes of section 2320 of title 10, United States Code.

(3) For the purposes of the pilot program, a qualifying contract or subcontract is a contract or subcontract, respectively, with a nontraditional defense contractor that—

(A) does not exceed \$50,000,000; and

(B) is either—

(i) a firm, fixed-price contract or subcontract; or

(ii) a fixed-price contract or subcontract with economic price adjustment.

The interim rule interprets the statute to mean that both the prime contract and the subcontract must qualify in order for the subcontract to qualify.

§ 212.7003. This does not seem mandated by section 847 and means that a traditional defense contractor who gets a nontraditional defense contractor to work as a subcontractor on the initial phase, as DOD and 10 U.S.C. § 2173 encourage such a contractor to do, will not be able to use the nontraditional business in the follow-on work unless it agrees to abide by all the FAR and DFARS standards.

Treating IP Flexibly

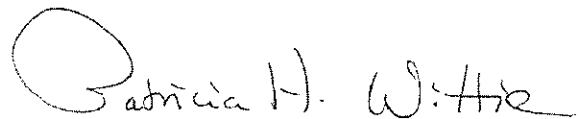
The interim rule states, as does the statute, that funding may be treated as mixed for purposes of negotiating technical data and computer software rights.

§ 212.7003. The statutory authority is appropriate but the implementing regulations should expressly recognize that the contracting officer already has authority to negotiate lesser rights under DFARS 227.7103-5(d). In fact, it is DOD policy to take only the minimum rights needed, DFARS 227.7103-1(a). It is not DOD policy to take the maximum rights to which it is entitled when there is full government funding, if those rights exceed the agency's needs. Office of Under Secretary of Defense for Acquisition, Technology and Logistics, *Intellectual Property: Navigating Through Commercial Waters*, Chap. 1 (Version 1.1 October 15, 2001). Thus the final rule should expressly state that the statute reconfirms existing authority each contracting officer has under the existing DFARS and that DOD should only be negotiating for the minimum rights it needs as provided in DFARS 227.7103-5(d) and 227.7103-1(a).

The final rule should also state expressly that the contractor is not required to change its accounting practices if the government uses this authority to agree to deem the funding mixed. That is, the fact that the contractor allocates no private funding to a "deemed" mixed funding project, will not be grounds to question costs or the "deemed" mixed funding status in any audit or other review. The statutory authority does not require changes to accounting practices, and if a contractor were to change its practices to make funding mixed when under its normal procedures it would not be mixed, those changes could be subject to challenge.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

A handwritten signature in black ink, appearing to read "Patricia H. Wittie". The signature is fluid and cursive, with a large initial "P" and "W".

Patricia H. Wittie
Chair, Section of Public Contract Law

cc: Robert L. Schaefer
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Council Members

Ms. Amy Williams
December 28, 2004
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